IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO **DIVISION OF FINANCIAL MANAGEMENT** **FEBRUARY 2004 VOLUME XXVI NO. 8**

This year should be a banner year for the U.S. economy. After three years of sub-par growth, a positive alignment of factors should boost real GDP growth to over 4.0% in 2004—well above its estimated long-run potential. The out years also look promising. Global Insight predicts the economy will expand over 3% annually from 2005 to 2007. This comes as a welcome change after several years of disappointment. However, the future is not without its challenges. The U.S. federal budget and trade deficits come immediately to mind.

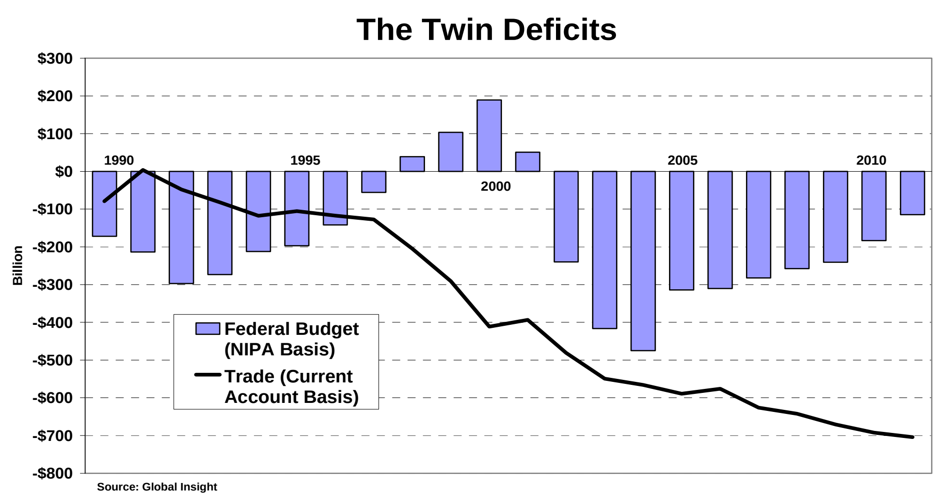
Federal budget deficits are worrisome because the federal government must borrow money to finance its spending, which puts upward pressures on interest rates. This raises the borrowing cost for the private sector, which retards capital spending. This lowers capital accumulation, which reduces potential economic growth. Trade deficits are not a problem as long as someone is willing to finance them. However, when they get too large, creditors begin to demand a higher return for their investments, putting upward pressure on interest rates.

The U.S. economy started its record expansion in the early 1990s, and the federal government was in surplus by the late 1990s. Unfortunately, the surplus was short lived, and by 2002 the budget was back in the red. This 180-degree change reflected the impact of several factors including; the recession, federal tax cuts, the war with Iraq, and the war on terrorism. For 2003 the federal government deficit is estimated to be $416 billion. It is expected to peak at $475 billion in 2004.

A valuable lesson from the 1990s was that a strong economy is one of the best remedies for the federal budget deficit. This is because during prosperous times the federal government's revenues are increasing while its outlays are being reduced. The current recovery should also help shrink the federal budget deficit. However, the federal budget is not expected to return to a surplus in the near future. After rising to nearly one-half trillion dollars in 2004, the federal budget deficit should gradually decline to about $300 billion by 2008.

Ironically, America's economic strength relative to other countries is one of the reasons for the trade account deficit. For several years the U.S. economy has been the main engine of global economic growth. As such, it has been a magnet for goods and services from other countries seeking healthy markets. Exports have also been hurt by the strong dollar, which made American products relatively more expensive compared to imports. The U.S. trade deficit went unnoticed for a while. But by 2003 the current account deficit was nearly $550 billion, or about 5% of GDP. Like an elephant in the living room, the current account deficit is too large to ignore, and about as hard to get rid of. In fact, the deficit is forecast to expand over the next few years and remain about 5% of total output.

The huge trade deficit has generated a fair amount of finger wagging from other countries calling for U.S. to get its house in order. But one has to wonder about the sincerity of this criticism. For example, Europe has failed to generate a sufficient level of internal growth. In fact, The European Central Bank has been raising its interest rates. While this has caused the euro to rise versus the U.S. dollar, such tight monetary policy threatens near-term economic growth on the Continent. Japan remains dependent on an economic model that stresses exports as the way to prosperity. It recently defended this model by purchasing U.S. dollars in the currency market in order to keep the dollar from falling further against the yen. Interestingly, the value of the dollar against the Chinese yuan has remained virtually unchanged all year. This is because China has pegged the value of its currency to the dollar to ensure its products remain attractive to American consumers. It also helps explain why America's largest trade deficit is with China.



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General Fund Update

As of January 31, 2003

Revenue Source	FY04 Executive Estimate[3] ($ Millions)	DFM Predicted to Date ($ Millions)	Actual Accrued to Date ($ Millions)
Individual Income tax	895.8	545.6	536.5
Corporate Income tax	100.1	49.1	42.0
Sales Tax	884.1	539.6	534.1
Product Taxes[1]	45.3	26.8	26.5
Miscellaneous	150.9	90.8	94.0
TOTAL GENERAL FUND[2]	**2,076.2**	**1,251.9**	**1,233.1**

1 Product Taxes include beer, wine, liquor, tobacco and cigarette taxes
2 May not total due to rounding
3 Revised Estimate as of January 2004

General Fund revenue was $11.3 million lower than expected in January, the second consecutive month revenues have been below the target this fiscal year. The weakness in January was concentrated primarily in the individual income tax, whereas in December the weakness was concentrated in the corporate income tax. Sales tax was a contributing factor to the revenue weakness in both December and January.

Individual income tax revenue was $9.5 million lower than expected in January. On the collection side, withholding collections were $3.9 million lower than predicted and filing payments were $2.2 million lower than predicted for the month. Refunds were $3.4 million higher than expected. The larger-than-expected amount of refunds paid in January reflects the recent improvements in tax filing technology and are not a cause for concern. The variance in filing payments is also not a source of apprehension, since December was ahead by $3.9 million, leaving the combined December/January filing payments ahead by $1.7 million. January's weakness in withholding collections is the only source of concern in the individual income tax results, since it follows a similar shortfall in December. One possible explanation of this weakness is that expectations for a weak holiday sales season held back seasonal hiring.

Corporate income tax revenue rebounded a bit in January, coming in $0.3 million higher than expected. Filing payments were $1.0 million above expectations, while quarterly estimated payments were $0.9 million lower than predicted. Refund payments were $0.2 million lower than expected for the month.

Sales tax revenue turned in another sluggish performance in January, coming in $3.2 million lower than expected. This follows December's shortfall of $2.3 million, and paints a picture of a very disappointing holiday sales season. Only one other month (September) has fallen short of expectations this fiscal year.

Product taxes were $0.3 million higher than expected for January based on strong collections from the cigarette tax and tobacco tax. Miscellaneous revenues were $0.4 million above target for the month of January. This does not include $0.3 million in interest earnings that were omitted from December's receipts by mistake. The miscellaneous category is now $3.2 million ahead of the predicted amount for the fiscal year to date.